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IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

No. 592.

WILLIAM H. OSBORN, CHANNING F. MacNEIL, LEWIS C. ADAIR, *et al.*,

Appellants,

vs.

THOS. W. OZLIN, WILLIAM MEADE FLETCHER and LESTER HOOKER, etc., *et al.*,

Appellees.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF VIRGINIA.

REPLY BRIEF OF APPELLANTS.

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REPLY BRIEF OF APPELLANTS.

This brief is filed in reply to the contentions made in the brief of the appellees, and in particular to the following contentions there presented:

1. That the challenged statute does not prohibit the making outside Virginia of contracts which include Virginia risks.

2. That Virginia has the power to regulate the negotiation and also the terms of such contracts.

3. That the challenged statute embodies a regulatory power valid as an exercise of the police power.

4. That Virginia can control and regulate such out-of-state negotiations and contracts because they are made in exercise of a franchise granted by Virginia.

Conflicting statements of fact in the briefs of the parties may be explained by the circumstance that most of the citations of fact in the briefs of appellants refer to the Findings made by the Court below, while more than four-fifths of the citations made by appellees refer to items of testimony. Some of the more striking of the statements are without support of substantial evidence in the record.*

The "Montana Case."

Attention is respectfully called to the decision in *Springfield Fire & Marine Insurance Co. v. Holmes* rendered March 16, 1940, by a three judge statutory Court in the District of Montana. The Court, consisting of Haney, C. J., Pray, D. J. and Baldwin, D. J., there held unconstitutional a statute of Montana, in some respects similar to the statute here under review, on substantially the same legal grounds urged in Point III of appellants' main brief. Copies of the opinion of that Court will be handed up on argument.

*Cf. That rebating is customary in New York (Br. 75); that in New York agents have been put out of business by the brokers (Br. 76); that Virginia has forbidden the use of multiple coverage policies (Br. 157), etc.

I.

THE REAL PURPOSE OF THE STATUTE IS TO INCREASE THE INCOME OF VIRGINIA INSURANCE AGENTS.

Appellants contend that the main and the only effective purpose of the statute is to ensure the payment of full producers' commissions to resident agents of Virginia upon insurance written out of the State and covering Virginia risks regardless of whether or not they have in fact produced the business.

Replying to this contention, appellees specify five specific purposes sought to be accomplished by the statute (Br. 13-14). Three of these purposes are frankly admitted to be attempts to adjust alleged competitive inequalities between residents of Virginia and persons or corporations engaged in business outside that state. The other two purposes are defined as attempts to secure the services of Virginia resident agents for the benefit of holders of insurance contracts covering risks in Virginia, for the benefit of the state as an aid in providing policy and fire protection, etc., and "to assist in bringing within the regulatory control of the State as to rates, taxes and other matters, insurance contracts negotiated *or made* outside the State" (Br. 14).

The Court below, in reviewing these purposes, made no finding that any of the competitive disadvantages complained of were due to discriminations or other practices which were in and of themselves wrongful or unlawful. Nor did the Court hold that they constituted unfair competition. Other purposes attributed to

the statute in appellees' brief are the desire (1) to break up the centralization of insurance business in New York City and other large cities (Br. 21-22); (2) to restrict and limit the business of non-resident brokers who are declared to be parasites on the business (Br. 10) and (3) to equalize the cost of insurance in Virginia by increasing the cost of insurance written on policies outside the state which include Virginia coverage (Br. 78), and to reduce the alleged advantage which a corporation doing a nationwide business enjoys over its Virginia competitor (Br. 106).

All of the alleged evils complained of by appellees result from the use of master policies or multiple coverage (sometimes called "hotch-potch") contracts. These contracts are in general use throughout the country because of the advantages in convenience and in lower cost which they afford to the assured. The statute makes no mention of these policies. Appellees criticize their use (Br. 157); but they do not assert that the purpose of the statute is to abolish them.

It is significant that the Court made no finding that the laws of the State of Virginia had actually been violated in any instance because of the use of these policies.

The Court below believed that the writing of out-of-state master or multiple coverage contracts made it difficult for Virginia to enforce certain of its laws dealing with insurance rates, because it might be possible to dilute the rate paid in Virginia by means of a concession in rate made in another state (Op. R. 52-53). The Court however specifically found that distinct benefits to the assured resulted from the use of these

contracts and that these benefits could not be had if the separate exposures were insured through local resident agents (Op. 50).

Respondents err in intimating that the use of these contracts is in any way illegal or improper (Br. 157). Virginia in the past has recognized and sanctioned their use. The former statute required that all forms of insurance on Virginia risks should be issued on a contract separate and distinct from insurance covering risks in other states (R. 543). But the State Insurance Commissioner, by official ruling, held that where a (master) contract was written out of the state covering operations in several states, including Virginia, the Virginia statute would be complied with if the Virginia coverage were written on a separate Virginia policy, schedule or declaration, which, in turn, must be written in full compliance with the resident agency laws of Virginia (R. 568). The former "Resident Agency Law" was enacted with the declared purpose of requiring companies to do business in Virginia through resident agents, but the State Insurance Commissioner held that the contract signature required by this statute to be made by a resident agent might be made by salaried employees of the issuing company who were registered as agents by the state (R. 543-544).

As the law stood therefore prior to the enactment of the new statute, companies were permitted to write master or multiple coverage contracts including coverage within the State of Virginia, provided only that that portion of the insurance which covered the Virginia risk should be identified and written in the form of a separate contract or declaration and written at the

rate required by Virginia law and countersigned either by a resident agent or a salaried employee of the company who was a licensed agent.

Appellants respectfully submit: (1) That by these former statutes, regulations and interpretations the State of Virginia exhausted, if not exceeded, all of its constitutional power to deal with or regulate out-of-state master or multiple coverage contracts. (2) That in any event, the challenged statute will not alleviate inequalities or disadvantages which may result from the use of such contracts.

The provisions of the previous statutes, rulings and interpretations seem to confirm the contention of the appellants that the only real purpose of the new statute was to compel payment to resident agents of producer's commissions for countersigning the separate Virginia contract negotiated out-of-the-state. The State Insurance Commissioner has now ruled that under the challenged statute the separate Virginia contract may be signed by any full time employee of a resident agent acting under power of attorney (R. 567). The signing or countersigning of the contract under the new statute is therefore a perfunctory act and the statute imposes no further responsibility or duty upon the resident agent.

II.

THE STATUTE DOES PROHIBIT THE MAKING OF CONTRACTS OUTSIDE OF THE STATE COVERING RISKS IN VIRGINIA.

At the outset Appellees' brief asserts that the challenged statute does not forbid or undertake to regulate the making of contracts outside the state (Br. 26). This attitude is later modified to the point of asserting that Virginia has jurisdiction to regulate the making of such contracts (Br. 68).

> "Insurance companies, legally authorized to do business in this State, except life, title and ocean marine insurance companies, *shall not make* contracts of insurance or surety on persons or property herein, *except through* regularly constituted and registered *resident agents or agencies* of such companies."

This is the first, and key sentence, of Section 4222 (a) of the Code of Virginia, asserted by the appellants to be unconstitutional. Subsequent sections impose penalties for the violation of its provisions. Clearly and on its face, this provision prohibits the plaintiffs from making, outside of Virginia, contracts of insurance and surety on persons or property in Virginia. The District Court so read its clear provisions (Op. R. 43). Yet the brief of Appellees contains lengthy argument upon the metaphysical distinction that the statute does not prohibit the doing of acts outside of Virginia, but only requires that they be done within Virginia. The fact remains, however, that if the appellants do make, outside of Virginia, contracts of insurance or

surety covering property or persons in Virginia, they will be acting in a manner prohibited by the statute and are subjected to penalties imposed by it. The fact also remains that this Court has repeatedly held such statutory provisions beyond the power of a state, and unconstitutional (App. Br. 19-23).

III.

THE STATUTE CANNOT BE JUSTIFIED AS A PROPER EXERCISE OF REGULATORY POWER.

A large part of the Appellees' brief (pp. 30-108) is apparently written on the assumption that the statute here challenged by the appellants is one regulating the performance and servicing of insurance and surety contracts, since the argument is directed to the claim that Virginia has authority and power to impose such regulation. Yet the appellants complain of no such regulation. Careful examination of the challenged statutes, set forth in the Appendix to plaintiffs' brief (pp. 49-66) does not reveal any provision regulating or even mentioning performance or servicing of the contract. In fact there are no such statutory regulations.

Appellants assert that the requirements of the statute bear no necessary or intrinsic relation to any "evils" which it is within the power of Virginia to correct (Br. 14). As defined by Appellees (Br. 14) the only two vital requirements of this statute are (1) that the separate policy or declaration covering the Virginia risk shall be countersigned by a resident agent, and (2) that this resident agent shall be paid

the full producer's commission, all of which he must retain unless the non-resident broker who in fact produced the business was licensed as such by Virginia. In reply to this contention by appellants, respondents list six alleged evils which they assert the new statute will eliminate.

1. Rate-cutting by the companies.

Appellees assert that the new statute will prevent rate cutting by the companies. Master policies, or multiple coverage policies, covering risks in more than one state are "equity rated" or "experience rated"—that is the aggregate risks covered are rated on the basis of the past records of the assured in accident and loss on all the combined risks (Op. R. 50). Sometimes this rating is changed retrospectively because of this experience record. Virginia fixes by statute the rate to be charged for three types of insurance, viz.:—Surety, Workmen's Compensation and Automobile liability. It fixes no rates as to other types of casualty insurance. Appellees argue that, although the Virginia risk is embodied in a separate contract written and signed by a resident agent on which the full premium based on the Virginia statutory rate has been paid, the assured will in effect be receiving a rate concession unlawful under the Virginia law if, contemporaneously, he receives through the master contract a lower rate than the ordinary rate (although a lawful rate) upon other risks in other states. But assuming that the over-all rate so resulting does "dilute" the charge made for the Virginia coverage, this is not due to any act done within Virginia jurisdiction, nor is it due to any unlawful or wrongful act.

The *St. Louis-Compress case* (262 U. S. 346) and the *Tafoya case* (270 U. S. 426) appear to hold by analogy that Virginia cannot regulate the cost or charges for insurance made in other states or give extra-territorial effect to its statutes. But assuming that Virginia had jurisdiction to prohibit the making outside of Virginia of a master contract covering a Virginia risk at lower cost than the rate prescribed by it, the new statute will not remedy the situation. For no statute of Virginia can prevent an assured who has paid the full legal rate on his risks located in Virginia from contemporaneously securing a master contract covering all of his risks located in other states. Presumably the premium for such a master contract would be adjusted to reflect the benefit to the assured of his past experience upon the various risks covered, including the past record within Virginia. Even under the new statute, therefore, the cost to the assured of his aggregate coverage would be the same as if such master contract included the Virginia risk.

2. Rebating of commissions by non-resident brokers.

Throughout respondents' brief all forms of bargaining reductions or adjustments or concessions in the amount of commissions are indiscriminately termed "rebates" or "unlawful discriminations." A sinister aspect is thus given to lawful transactions occurring in the ordinary course of business.

In the proper sense of the word "rebate" there is no evidence, except hearsay, in the record that "rebating" was practiced in writing out-of-state policies. Reduced premiums in master contracts are not the result of "rebates." What appellees are complaining of is not rebating, but the process of bargaining

over the aggregate cost of master policies, or multiple coverage contracts. In this process concessions in price are commonly made. These concessions frequently include contributions by the broker of a portion of his usual commissions. The opinion of the Court below fully described the elements and business practices which result in cheaper cost of master contracts (Op. 50). The Court found that in fixing a premium for a master contract, the insurance company gives consideration to the assured's experience rating in the various fields of risk and thus is able to arrive at a reduced premium to which a reduction in the agent's commission is usually a contributing factor (Op. R. 50). It is by offering this reduced premium, which may include a reduction of the producer's commission, that the business is sold. What the appellees chiefly complain about is not a "rebate" of commission but a reduced premium arrived at by the process of competitive bargaining.

Appellees at one point assert (without record reference) that "rebating" is a customary practice in the State of New York (Br. 75). There is no substantial evidence and the Court below made no finding to this effect. Rebating was formerly forbidden within the State of New York on premiums paid on risks located within that state. *American Smelting, etc. Co. v. Stettenheim*, 164 N. Y. S. 253, was decided under the old law. The amended New York statute (L. 1939, Chap. 882, Sec. 188), now prohibits rebating on commissions on all policies issued within that state without regard to the location of risks.

Except in the states and in the few lines of insurance where the rate has been fixed by law there is nothing illegal or improper in the practice of bargaining as to the rate to be charged for the remaining risks.

This practice operates invariably to the benefit of the assured and it is an ordinary incident of competition. The larger the business of the assured, or the larger the variety of risks involved, or the more experience and expert knowledge the broker possesses, the greater will be the legitimate competitive advantage of the producing broker in driving a bargain for his client, the assured. The fact that the business of insurance may be charged with a public interest does not affect this basic consideration provided that in each state any prescribed legal rate is observed.

3. Unfair competition between non-resident brokers and Virginia agents.

The Court below, although finding that competitive advantage accrued in certain circumstances to some out of state producers, made no finding of unfair competition or of unlawful discrimination as between non-resident brokers and Virginia agents. Appellees assert that companies now favor the New York broker, because of his volume of business, by quoting him a better rate on a master policy than the companies would quote to a Virginia agent. It is claimed that the statute will adjust or ameliorate this competitive advantage by requiring the payment of a full commission to a Virginia agent. In support of this claim of discrimination appellees cite the testimony (chiefly hearsay) of Mr. McNeil (Br. 624-5). But the Court below found that where the Virginia agent is not able to obtain the lower rate, his failure results from his inability to acquire the requisite information concerning the risk upon which the company bases the lower rating. Mr. McNeil's testimony is to this effect (R. 625). In any event, there is no finding that the com-

panies discriminate against a Virginia agent by quoting lower rates to New York brokers than to Virginia brokers. On the contrary, the Court found that the competitive disadvantage of the Virginia agent was due to his lack of the information and the experience requisite to make him expert in the rating and underwriting of multiple risks (Op. R. 51).

Assuming that the Virginia agent in certain cases is now at a competitive disadvantage, the effect of the new statute will be to give the Virginia agent a competitive advantage over all other agents writing multiple coverage contracts. Under this statute the Virginia agent writing a master contract can quote a rate which will include the payment of only one commission, whereas the non-resident agent and broker in the future must quote a rate which shall include the payment of the usual commission to himself, and in addition, at least one-half of the customary commission to some resident Virginia agent. Thus in solicitation for equity rated master contracts which include coverage in Virginia and other states, this statute, to this extent, will place the Virginia agent in a preferred position in his competition with non-resident brokers agents.

4. Unfair competition between foreign insurance company groups and Virginia insurance companies.

Virginia insurance companies are said to labor under the handicap of having no group of affiliated fire, casualty and surety companies, so that they are unable to compete with foreign companies in the writing of master contracts. This disadvantage will be alleviated, it is claimed, by preventing the non-resident broker from reducing his commission and by the enact-

ment by other states of similar statutes preventing their resident brokers from rebating commissions on contracts covering risks in other states. (Br. 78). There is no prohibition in Virginia against domestic companies affiliating in groups. As stated, New York now prohibits rebating of commissions on contracts covering risks situated in states other than New York. It accomplished this by a statute similar to Virginia's rebating statute (Sec. 4222 (c) Code of Virginia)—not by a statute requiring payment of a commission to a New York agent.

Appellees concede that the Virginia statute will not relieve the Virginia domestic insurance companies from whatever disadvantage they are now under. The only result in this regard anticipated by appellees is the nebulous expectation that: "Judicial confirmation of the state's jurisdiction to exercise its police power in connection with its out-of-state transactions will make possible the passage of legislation which will correct the evil." (Br. 78-79).

5. Depriving Virginia agents and citizens of insurance agency commission business belonging to them.

Appellees assert that insurance written on risks located in Virginia is "Virginia business" belonging to the citizens of that state (Br. 79). Here as frequently elsewhere appellees confuse the property insured with the business of writing insurance upon it or upon risks incidental to its use.

They assert that one "evil" to be relieved by the statute is the placing in New York of insurance upon a Virginia risk without payment of a commission to some Virginia agent (Br. 80). In the *Tafoya* case

(270 U. S. 426) New Mexico had endeavored to correct the same "evil". Its statute provided for the suspension of any company paying a commission to any one not a resident of New Mexico for writing a policy covering a New Mexico risk. This Court held that statute unconstitutional. New Mexico prohibited payment of a commission to any one other than a resident of New Mexico. Virginia has affirmatively required payment of the commission to a Virginia resident agent.

6. The present lack of a Virginia agent to service Virginia risks contracted for outside the state.

The work done by a Virginia commission agent in servicing a contract is work done by him when, and only when, he is the originator or producer of the business. Appellees complain that hitherto neither the insurer nor the broker has had the benefit of the services of a Virginia local agent in servicing a multiple coverage contract (Br. 80). But the Court below specifically found that neither the insurer nor the assured had any desire or need for the services of a Virginia agent in the servicing of the contract (Op. R. 56).

Both appellants and the Court below speak of the possible or probable good which will result from the "association of a resident agent" with the insurance contract (Br. 39; Op. R. 55, 56). This is a misleading expression, because the statute imposes no duty or responsibility upon such agent, and the Court has found that neither the insurer nor the assured need or desire his services. The statute requires that at the inception of the contract he is to be paid the full producer's commission. The only act required of him by the stat-

ute is the placing of his signature upon the contract and the State Insurance Commissioner has ruled that this signature may be attached by any of his full time employees acting under power of attorney.

It is important to note also that there is no legal method by which the insurer or the assured can compel the resident agent to perform any service in connection with the policy signed by him or his employee.

Complaint is also made that Virginia has been deprived of the services of her resident agents in the prevention of accidents when Virginia risks are covered by master contracts made outside the state (Br. 80). On the other hand, there is no finding by the Court that the services which the resident agent may render will result in the reduction of accidents. The finding of the Court is that the lower premiums for master policies are the result of "improved loss experience from scientific servicing of risks" (Op. R. 50)—services not rendered by the local resident agents. The inference is clear that the association of these agents in contracts covering Virginia risks will not assist in the prevention of accidents.

It is believed that a casual comparison of the two vital requirements as to signature and commission of

the challenged statute with the so-called evils listed above demonstrates how insubstantial and uncertain of effect is the relationship between the statute and these so-called evils. That there is no intrinsic or legitimate relationship seems clear, because the statute neither forbids the use of multiple coverage contracts nor does it in terms purport to regulate in any manner any act to be done within the state in the carrying out of the contract.

IV.

IN MAKING A CONTRACT OUTSIDE VIRGINIA THE LICENSE GRANTED BY VIRGINIA TO DO BUSINESS IN THAT STATE IS NOT EXERCISED.

The appellees contend that the making outside of Virginia by a foreign corporation of a contract of insurance covering a Virginia risk is an exercise of the license granted by Virginia to the foreign corporation to do business within that state (Br. 48 *et seq.*). In other words, Virginia contends that the license granted a foreign corporation empowers Virginia not only to regulate the performance in Virginia of a contract made outside the state, but also to regulate those terms and provisions (as to premium and commission) of such a contract which do not require performance and are not performed within Virginia. For such contention, reliance is placed upon *Bothwell v. Buckbee, Mears Co.*, 275 U. S. 274 and *Compania General de Tabacos de Filipines v. Collector of Internal Revenue*, 275 U. S. 87. The *Bothwell* case has been fully discussed in our main brief (pp. 26-29). The question determined in the *Compania General de Tabacos* case

was solely the right of the territory, in taxing the foreign corporation for the privilege to do business there, to consider in *measuring such tax* a premium on a contract of insurance written outside of the territory but covering property therein. That question Chief Justice Taft said was a close one, and it was decided on the authority of *Equitable Life Assurance Society v. Pennsylvania*, 238 U. S. 143. In that case Mr. Justice Holmes, after assuming that the state could not prevent such contracts, stated that the only question concerned was the mode of measuring the tax.

In no reported case has any Court given extra-territorial effect to a state statute in the manner or to the degree contended for by the appellees. On the facts as stated above and also in appellants' main brief, it is submitted that the powers of the state of Virginia cannot constitutionally be expanded to support this particular contention of the appellants as to extra-territorial jurisdiction.

SUMMARY.

Appellants' claims are, basically, two-fold: (1) That Virginia has no power to prohibit and penalize their making contracts outside the State, and (2) That, in any event, Virginia may not impose upon the plaintiffs an obligation to pay a local agent for the perfunctory act of countersigning a policy produced by another the usual and customary producer's commissions.

It is submitted that appellees' brief deals with neither of these claims. Instead of the first, counsel's brief, as above stated, deals with the constitutional justification for an imagined statute regulating the per-

formance and servicing of contracts. Instead of the second, appellees rest upon the possibility that the countersigning resident agent might do the work the producer does, though it is clear, and the Court below has so found, that the statute imposes no such duty upon the countersigning resident agent. More important the Court found affirmatively that neither the insured nor the insurer desires him to perform such services, and that in many instance the Virginia resident agent is not equipped or able to perform them.

Since the matters considered in the appellees' brief thus seem, to a large extent, foreign to the issues involved in this case, a further reply to its arguments would serve no relevant purpose.

However, we do emphasize the implications of this statute as they extend beyond its immediate operation. On pages 13 and 14 of their brief, the appellees have set forth what they conceive to be the purposes of this statute. Apparent from this statement and from others above cited on appellees' brief is the fact that Virginia has, by this statute and the penalties it imposes, attempted to divert business from other states and into Virginia. In other words, this is a tariff act, a tariff to foster local business and strike down foreign competition. The brief of appellees expresses this idea frankly. "States compete for business to be carried on within their borders, just as nations compete in world commerce" (Br. 79). That competition exists one may not doubt. But if the states may implement this competition by legislation to confine business within their borders and to divert it from others, the separatist tendencies thus sanctioned by statute, and the statutory recriminations thus invited, will leave

little of the federal system contemplated by the Constitution.

We respectfully submit that the decisions of this Court referred to in our main brief holding statutes similar to Virginia's to be unconstitutional have had as their basis the realization that the extra-territorial application of state laws, and the attempt thereby to shepherd all possible business within the boundaries of particular states, is inconsistent with the idea of polity based upon the complete freedom of intercourse and interdependent relationships of all citizens.

Respectfully submitted,

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